

Speech

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Good afternoon Ladies and Gentlemen, Coordinating Minister Bakrie, Ambassador Siregar, the Hon. Saleh Afiff and other friends. It is a pleasure to be here.

The December 26 Earthquake and Tsunami has had an enormous impact on Indonesia and the Economic Program of the Yudhoyono Government. USAID and other U.S. government agencies have worked closely with the GoI to provide relief and other assistance to those affected. USAID will continue to support the GoI in the rehabilitation and reconstruction of Aceh. The tragedy in Aceh has captured everyone's attention, it can not distract us from our fundamental goal of driving growth, jobs and prosperity for all of Indonesia.

This morning, we recognized several Kota and Kabupaten that are leaders of economic growth in Indonesia. Together they are taking steps to build stronger local and national economies. They are creating an environment that invites business, and which creates jobs that lead to prosperity.

Today, these local governments illustrated that they must and can put into place economic policies and strategies that build regional and local competitiveness. Building from the bottom, making local economies the engines of national economic growth is a strategy that president Yudhoyono has advanced, and which we too embrace.

A bottom-up approach to economic growth is a direct outcome of decentralization. The question is: What can we do to sustain and accelerate this positive activity, and to ensure the revitalization of local economies?

The President, the Vice President, and the cabinet have expressed firm commitment to making Indonesia a better place to do business, to eradicating corruption at all levels and to making Indonesia more competitive. USAID will continue to support the President and his cabinet in achieving these goals.

Helping Indonesian business to compete and building local government capacity to establish an environment where business can grow and create jobs is among USAID's leading objectives in Indonesia.

USAID assistance to local government has been broad in scope, including participatory planning, performance-based budgeting, and improved management of services, but all of these programs have one common objective – to help local governments improve the quality of life for Indonesia's citizens. With that in mind, let me just say a few words on the importance of good governance and the key role that local governments play in realizing Indonesia's full potential.

The future of Indonesia's democratic and economic transformation is in the regions. It is imperative, therefore, that local governments establish systems that are transparent - open to public scrutiny and public input - and that provide quality public services to business and the community at large.

Ultimately, Indonesia's experiment with decentralization, which is the cornerstone of the democratic and economic reform process, will only succeed if local governments engage their constituents, including business, in local development, and if local governments are able to provide quality services that foster economic growth.

Over the past years, USAID has helped some 80 local governments in 7 provinces strengthen and deepen local community involvement in local planning, budgeting and governance. I recognize that this approach has helped many local governments improve their performance on planning, economic development and the efficient delivery of basic services, and I trust that local government throughout Indonesia will continue to advance reforms.

Getting the policies and regulations right is one element of a favorable investment climate. But it is only one part. Having a skilled and well-educated labor force is perhaps even more of a determinant of investment potential and attractiveness. All of the countries that have built growth upon substantial inflows of foreign direct and domestic investment, have succeeded because they have invested heavily in their youth and in their people.

USAID will invest up to \$157 million over the next five years in education. We will focus on primary and secondary education, which will be the source of Indonesia's next generation of business leaders and entrepreneur.

With the Government's expressed commitment to dedicate a portion of the savings resulting from the reduction of energy subsidies to education, we are confident that our investment in education will gain traction that will propel the Indonesian economy forward.

Since taking office, the Government has made some progress on fundamental economic improvement. Economic growth accelerated in the fourth quarter of 2004, lifting the annual rate to 5.1%. The availability of financing, in particular for SMEs, has grown throughout the last year and this trend is expected to continue. Since November, all of the major international rating Agencies have boosted Indonesia's sovereign rating to the equivalent of B+, several notches below investment grade, but clearly a move in the right direction. Less than two weeks ago, Indonesia was removed from the international black-list of non-cooperating countries because of its strident efforts to combat financial crime and corruption.

A mood of optimism is palpable, and I share this hope for Indonesia. As I mentioned this morning at the KPPOD conference, I have never been more confident than I am today. The Government has advanced a sound economic program that is sensible and practical.

The Government, in its first hundred days, has produced credible results that are fueling optimism and that will stimulate further gains. The perception of Indonesia in the international marketplace is clearly changing, as evidenced by the rating upgrades. The government must now work with increasing vigilance to ensure that reality continues to match perception. Efforts to further improve and strengthen the investment and business climates are essential.

At the mid-January Infrastructure Summit, Coordinating Minister Bakrie unveiled plans for dozens of major projects worth billions of dollars. In order for the plans to become reality, implementing laws and regulations must be passed in order to facilitate investment, and protect investors. Critical legislation, such as the Investment Law, which is the object of intense effort by a top-caliber Indonesia working group, will be essential to defining the terms of future domestic and foreign investment.

As has often been quoted, the World Bank estimates that it takes 570 days to enforce a contract, and costs on average 126% of the contract value. Clearly this is untenable. Enforcing a bankruptcy takes more than 6 years, well above the regional average, and yields only 10 cents on the dollar. These barometers of the investment climate are closely-watched by the international community, and by many donors, including USAID.

Whereas improving these indicators of the investment climate is the object of USAID efforts, I am pleased that momentum is building behind reforms to improve the climate for small and medium-sized business, as well as for larger enterprises. The government

has pledged ongoing support for reforms that directly effect business, and this means reforms that drive the micro-economy and which translate directly into growth, jobs and income.

A first step in the process, is getting business to register. Registered businesses have access to credit and therefore can grow more quickly. Registered businesses tend to implement better practices with regard to labor. And registered businesses are more likely to pay their taxes and therefore contribute to a stronger and more stable Indonesia. Yet, the World Bank reports that registering a business in Indonesia is complicated, lengthy, and expensive. It takes a minimum of 12 procedures and 151 days.

According to Transparency International, business registration is among the most corrupt functions in government. Nearly 40% of the respondents to a recent survey said that business registration involved some form of bribe.

Indonesia can improve and, with local government, KADIN and KPPOD, USAID is keen to assist.

With USAID support, TAF has already established about a half-dozen one-stop-shops for various business, industry and other forms of registration, and decreased the time and cost it takes to register a business. In order to drive economic growth, the Government must ease the costs of doing business. USAID is ready to enhance its partnership with government and business to advance this goal.

Decentralization was necessary and it brought substantial democratic gains. Yet, decentralization has witnessed a startling increase in nuisance taxes and levies at the local and provincial levels. It's now more expensive to ship east Java apples to the capital, than it is to ship apples from New Zealand because many kecamatan and kabupaten along the road from Malang to Jakarta now levy a fee or tax. In Sulawesi more than 400,000 cocoa farmers generate more than \$500 million in foreign exchange annually. But trucks transporting beans from Polmas, Manuju and other places to the port at Makassar are stopped numerous times. Nuisance fees and taxes strangle domestic trade and threaten to make Indonesian exports less competitive.

The GOI must reduce and remove unnecessary regulation, and nuisance taxes. It must reduce friction that prevents efficient markets from functioning. I would strongly suggest that the Government move expeditiously to implement a Domestic Trade Law that outlaws these errant practices. I would also suggest that the GOI contemplate a law similar to the US Interstate Commerce Act, which facilitates trade and commerce between the fifty States. Though I am reluctant to suggest additional bureaucracy, the GOI may also want to consider establishment of an Interstate Commerce Commission that will oversee and regulate domestic trade in goods and services.

Indonesia will need to identify and implement solutions that are appropriate for Indonesia, taking into account regional economies and needs. Whatever decision is made, the objective is undeniable for all regions. Regulations and taxes that restrict business must be removed, and business must be encouraged to grow and create jobs.

As I mentioned this morning at the KPPOD conference, I have a long history in Indonesia, and looking forward I am confident that the new government will continue to implement and consolidate reforms that will generate growth at the local and national level. USAID will be a partner Indonesia can count on in this effort.

Thank you.